

## **I. EXPLANATION OF THE BILL**

### **A. Standard Deduction Tax Relief**

**(sec. 2 of the House bill, sec. 2 of the Senate amendment, and sec. 63 of the Code)**

#### **Present Law**

##### **Marriage penalty**

A married couple generally is treated as one tax unit that must pay tax on the couple's total taxable income. Although married couples may elect to file separate returns, the rate schedules and other provisions are structured so that filing separate returns usually results in a higher tax than filing a joint return. Other rate schedules apply to single individuals and to single heads of households.

A "marriage penalty" exists when the combined tax liability of a married couple filing a joint return is greater than the sum of the tax liabilities of each individual computed as if they were not married. A "marriage bonus" exists when the combined tax liability of a married couple filing a joint return is less than the sum of the tax liabilities of each individual computed as if they were not married.

While the size of any marriage penalty or bonus under present law depends upon the individuals' incomes, number of dependents, and itemized deductions, as a general rule married couples whose incomes are split more evenly than 70-30 suffer a marriage penalty. Married couples whose incomes are largely attributable to one spouse generally receive a marriage bonus.

Under present law, the amount of the standard deduction and the tax bracket breakpoints follow certain customary ratios across filing statuses. The standard deduction and tax bracket breakpoints for single individuals are roughly 60 percent of those for married couples filing joint returns.<sup>1</sup> Thus, the sum of the standard deductions for two single individuals exceeds the standard deduction for a married couple filing a joint return.

##### **Basic standard deduction**

Taxpayers who do not itemize deductions may choose the basic standard deduction (and additional standard deductions, if applicable)<sup>2</sup>, which is subtracted from adjusted gross income ("AGI") in arriving at taxable income. The amount of the basic standard deduction varies

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<sup>1</sup> The beginning point of the 39.6 percent rate bracket is the same for all taxpayers regardless of filing status.

<sup>2</sup> Additional standard deductions are allowed with respect to any individual who is elderly (age 65 or over) or blind.

according to filing status and is indexed for inflation. For 2000, the amount of the basic standard deduction for each filing status is shown in the following table:

**Table 1.--Basic Standard Deduction Amounts**

<u>Filing status</u>	<u>Basic standard deduction</u>
Married, joint return	\$7,350
Head of household return	\$6,450
Single return	\$4,400
Married, separate return	\$3,675

For 2000, the basic standard deduction for joint returns is 1.67 times the basic standard deduction for single returns.

#### **House Bill**

The House bill increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for a single individual. The basic standard deduction for a married taxpayer filing a separate return will continue to equal one-half of the basic standard deduction for a married couple filing a joint return.

Effective date.--The provision is effective for taxable years beginning after December 31, 2000.

#### **Senate Amendment**

The Senate amendment is the same as the House bill.

#### **Conference Agreement**

The conference agreement follows the House bill and the Senate amendment, with the modification that the provision is effective for taxable years beginning after December 31, 1999. The agreement further provides that the provision cannot be taken into account for estimated tax purposes prior to October 1, 2000.

**B. Expansion of the 15-Percent and 28-Percent Rate Brackets**  
(sec. 3(a) of the House bill, sec. 3(a) of the Senate amendment, and sec. 1 of the Code)

#### **Present Law**

##### **Rate brackets**

To determine regular income tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her taxable income. The rate schedules are broken into

several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. The income bracket amounts are indexed for inflation. Separate rate schedules apply based on an individual's filing status. In order to limit multiple uses of a graduated rate schedule within a family, the net unearned income of a child under age 14 may be taxed as if it were the parent's income. For 2000, the individual regular income tax rate schedules are shown below. These rates apply to ordinary income; separate rates apply to capital gains.

**Table 2.--Federal Individual Income Tax Rates for 2000**

<b><u>If taxable income is:</u></b>	<b><u>Then income tax equals:</u></b>
<i><u>Single individuals</u></i>	
\$0-\$26,250	15 percent of taxable income
\$26,250-\$63,550	\$3,937.50, plus 28% of the amount over \$26,250
\$63,550-\$132,600	\$14,381.50 plus 31% of the amount over \$63,550
\$132,600-\$288,350	\$35,787 plus 36% of the amount over \$132,600
Over \$288,350	\$91,857 plus 39.6% of the amount over \$288,350
<i><u>Heads of households</u></i>	
\$0-\$35,150	15 percent of taxable income
\$35,150-\$90,800	\$5,272.50 plus 28% of the amount over \$35,150
\$90,800-\$147,050	\$20,854.50 plus 31% of the amount over \$90,800
\$147,050-\$288,350	\$38,292 plus 36% of the amount over \$147,050
Over \$288,350	\$89,160 plus 39.6% of the amount over \$288,350
<i><u>Married individuals filing joint returns<sup>3</sup></u></i>	
\$0-\$43,850	15 percent of taxable income
\$43,850-\$105,950	\$6,577.50 plus 28% of the amount over \$43,850
\$105,950-\$161,450	\$23,965.50 plus 31% of the amount over \$105,950
\$161,450-\$288,350	\$41,170.50 plus 36% of the amount over \$161,450
Over \$288,350	\$86,854.50 plus 39.6% of the amount over \$288,350

### **House Bill**

The House bill increases the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for a single

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<sup>3</sup> Married individuals filing separate returns must apply a separate rate structure with tax rate brackets one-half the width of those for married individuals filing joint returns.

individual. This increase is phased in over six years as shown in the following table. Therefore, this provision is fully effective (i.e., the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return will be twice the size of the 15-percent regular income tax rate bracket for a single individual) for taxable years beginning after December 31, 2007.

<u>Taxable year</u>	<u>Joint return 15-percent rate bracket as a percentage of single return 15-percent rate bracket</u>
2003	170.3
2004	173.8
2005	183.5
2006	184.3
2007	187.9
2008 and thereafter	200.0

Effective date.--The provision is effective for taxable years beginning after December 31, 2002.

#### Senate Amendment

The Senate amendment increases the size of the 15-percent and 28-percent regular income tax rate brackets for a married couple filing a joint return to twice the size of the corresponding rate brackets for a single individual. This increase is phased in over six years as shown in the following table. The Senate amendment is fully effective (i.e., the size of the 15-percent and 28-percent regular income tax rate brackets for a married couple filing a joint return is twice the size of the corresponding regular income tax rate brackets for a single individual) for taxable years beginning after December 31, 2006.

<u>Taxable year</u>	<u>Joint return 15-percent and 28- percent rate bracket as a percentage of single return 15- and 28-percent rate bracket</u>
2002	170.3
2003	173.8
2004	180.0
2005	183.2
2006	185.0
2007 and thereafter	200.0

Effective date.--The provision is effective for taxable years beginning after December 31, 2001.

### **Conference Agreement**

The conference agreement follows the House bill, but with a different phase-in, as described in the following table:

<b><u>Taxable year</u></b>	<b><u>Joint return 15-percent rate bracket as a percentage of single return 15-percent rate bracket</u></b>
2000	170.0
2001	173.0
2002	178.0
2003	183.0
2004 and thereafter	200.0

The agreement further provides that the provision cannot be taken into account for estimated tax purposes prior to October 1, 2000.

Effective date.--The provision is effective for taxable years beginning after December 31, 1999.

### **C. Allowance of Nonrefundable Personal Credits Against Regular and Minimum Tax Liability (sec. 3(b) of the House bill, sec. 5 of the Senate amendment, and secs. 24, 26, and 32 of the Code)**

#### **Present Law**

#### **Allow nonrefundable personal credits to offset both the regular tax and the alternative minimum tax**

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the adoption credit, the child credit, the credit for interest on certain home mortgages, the HOPE Scholarship and Lifetime Learning credits, and the D.C. homebuyer's credit). Except for taxable years beginning during 1998-2001, these credits are allowed only to the extent that the individual's regular income tax liability exceeds

the individual's tentative minimum tax, determined without regard to the minimum tax foreign tax credit. For taxable years beginning during 1998 and 1999, these credits are allowed to the extent of the full amount of the individual's regular tax (without regard to the tentative minimum tax). For taxable years beginning during 2000 and 2001, the nonrefundable personal credits may offset both the regular tax and the minimum tax.<sup>4</sup>

An individual's tentative minimum tax is an amount equal to (1) 26 percent of the first \$175,000 (\$87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of a phased-out exemption amount plus (2) 28 percent of the remaining AMTI, if any. The maximum tax rates on net capital gain used in computing the tentative minimum tax are the same as under the regular tax. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments. The exemption amounts are: (1) \$45,000 in the case of married individuals filing a joint return and surviving spouses; (2) \$33,750 in the case of other individuals; and (3) \$22,500 in the case of married individuals filing a separate return, estates and trusts. The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds (1) \$150,000 in the case of married individuals filing a joint return and surviving spouses, (2) \$112,500 in the case of other unmarried individuals, and (3) \$75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

#### **Reduction of refundable credits by alternative minimum tax**

Refundable credits may offset tax liability determined under present-law tax rates and allow refunds to an individual in excess of income tax liability. However, the refundable child credit (beginning in taxable years beginning after December 31, 2001) and the earned income credit are reduced by the amount of the individual's alternative minimum tax.

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<sup>4</sup> The foreign tax credit is allowed before the personal credits in computing the regular tax for these years.

## **House Bill**

### **Allow nonrefundable personal credits to offset both the regular tax and the alternative minimum tax**

No provision.

### **Reduction of refundable credits by alternative minimum tax**

The House bill repeals the provisions that reduce the refundable child credit and the earned income credit by the amount of the individual's alternative minimum tax.

Effective date.--The provision is effective for taxable years beginning after December 31, 2001.

## **Senate Amendment**

### **Allow nonrefundable personal credits to offset both the regular tax and the alternative minimum tax**

The Senate amendment permanently extends the present-law temporary provision that allows the nonrefundable personal credits to offset both the regular tax and the minimum tax.<sup>5</sup>

### **Reduction of refundable credits by alternative minimum tax**

The Senate amendment is the same as the House bill.

### **Effective date**

The provisions are effective for taxable years beginning after December 31, 2001.

## **Conference Agreement**

### **Allow nonrefundable personal credits to offset both the regular tax and the alternative minimum tax**

The conference agreement follows the Senate amendment.

### **Reduction of refundable credits by alternative minimum tax**

The conference agreement follows the House bill and the Senate amendment.

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<sup>5</sup> The foreign tax credit will continue to be allowed before the personal credits in computing the regular tax.

**D. Marriage Tax Relief Relating to the Earned Income Credit**  
**(sec. 4 of the House bill, sec. 4 of the Senate amendment, and sec. 32 of the Code)**

**Present Law**

Certain eligible low-income workers are entitled to claim a refundable earned income credit (“EIC”) on their income tax returns.<sup>6</sup> The amount of the EIC an eligible individual may claim depends upon whether the individual has one, more than one, or no qualifying children, and is determined by multiplying the applicable credit rate by the individual’s earned income up to an earned income amount. The maximum amount of the credit is the product of the credit rate and the earned income amount. The credit is phased out above certain income levels. For individuals with earned income (or modified AGI, if greater) in excess of the beginning of the phase-out range, the maximum credit amount is reduced by the phase-out rate multiplied by earned income (or modified AGI, if greater) in excess of the beginning of the phase-out range. For individuals with earned income (or modified AGI, if greater) in excess of the end of the phase-out range, no credit is allowed. In the case of a married individual who files a joint return, income for purposes of these tests is the combined income of the couple.

The parameters of the EIC for 2000 are provided in the following table:

**Table 3.--Earned Income Credit Parameters (2000)**

	<b>Two or more qualifying children</b>	<b>One qualifying child</b>	<b>No qualifying children</b>
Credit rate (percent)	40.00	34.00	7.65
Earned income amount	\$9,720	\$6,920	\$4,610
Maximum credit	\$3,888	\$2,353	\$353
Phase-out begins	\$12,690	\$12,690	\$5,770
Phase-out rate (percent)	21.06	15.98	7.65
Phase-out ends	\$31,152	\$27,413	\$10,380

**House Bill**

The House bill increases the beginning point of the phase-out range of the EIC for married couples filing a joint return by \$2,000. Because the rate of the phase-out range is not changed by the House bill, the endpoint of the phase-out range is also increased by \$2,000. The effect of the increase in the beginning of the phase-out range is to increase the EIC for taxpayers in the phase-out range by an amount up to \$2,000 times the phase-out rate. For example, for couples with two or more qualifying children, the maximum increase in the EIC as a result of the provision will be \$2,000 multiplied by 21.06 percent, or \$421.20. The House bill also expands the number of married couples eligible for the EIC. Specifically, the \$2,000 increase in the end of the phase-out range will make married couples with earnings up to \$2,000 beyond the present-law phase-out range eligible for the credit. The beginning and ending points of the phase-out

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<sup>6</sup> A refundable credit is a credit that not only reduces an individual’s tax liability but also allows refunds to the individual of amounts in excess of income tax liability.



range of the EIC (including the \$2,000 increase for joint returns) will continue to be indexed for inflation, as under present law.

Effective date.--The provision is effective for taxable years beginning after December 31, 2000.

### **Senate Amendment**

The Senate amendment is the same as the House bill except that the Senate amendment increases the beginning and ending income levels of the phase-out of the EIC for married couples filing a joint return by \$2,500 rather than by \$2,000.

Effective date.--The provision is effective for taxable years beginning after December 31, 2000.

### **Conference Agreement**

The conference agreement follows the House bill, with the modification that the provision is effective for taxable years beginning after December 31, 1999. The agreement further provides that the provision cannot be taken into account for estimated tax purposes prior to October 1, 2000.

## **E. Compliance with Congressional Budget Act (sec. 6 of the Senate amendment)**

### **Present Law**

Reconciliation is a procedure under the Congressional Budget Act of 1974 ("the Budget Act") by which Congress implements spending and tax policies contained in a budget resolution. The Budget Act contains rules defining the scope of items permitted to be considered under the budget reconciliation process. One such rule, the so-called "Byrd rule," was incorporated into the Budget Act in 1990. The Byrd rule, named after its principal sponsor, Senator Robert C. Byrd, is contained in section 313 of the Budget Act. The Byrd rule is generally interpreted to permit Members to make a motion to strike extraneous provisions (those which are unrelated to the deficit reduction goals of the reconciliation process) from either a budget reconciliation bill or a conference report on such a bill.

Under the Byrd rule, a provision is considered to be extraneous if it falls under one or more of the following six definitions:

- (1) it does not produce a change in outlays or revenues;
- (2) it produces an outlay increase or revenue decrease when the instructed committee is not in compliance with its instructions;
- (3) it is outside of the jurisdiction of the committee that submitted the title or provision for inclusion in the reconciliation measure;

- (4) it produces a change in outlays or revenues which is merely incidental to the non-budgetary components of the provision;
- (5) it would increase the deficit for a fiscal year beyond those covered by the reconciliation measure; and
- (6) it recommends changes in Social Security.

#### **House Bill**

No provision.

#### **Senate Amendment**

To ensure compliance with the Budget Act, the provision provides that all provisions of, and amendments made by, the Senate amendment shall cease to apply for taxable years beginning after December 31, 2004.

Effective date.--The provision is effective on date of enactment.

#### **Conference Agreement**

The conference agreement follows the Senate amendment.

## **II. COMPLEXITY ANALYSIS**

The following tax complexity analysis is provided pursuant to section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998, which requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service (“IRS”) and the Treasury Department) to provide a complexity analysis of tax legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or a Conference Report containing tax provisions. The complexity analysis is required to report on the complexity and administrative issues raised by provisions that directly or indirectly amend the Internal Revenue Code and that have widespread applicability to individuals or small businesses. For each such provision identified by the staff of the Joint Committee on Taxation, a summary description of the provision is provided, along with an estimate of the number and the type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues. Time constraints prevented the staff of the Joint Committee on Taxation from consulting with the IRS regarding the provisions in the conference agreement that have widespread applicability.

### **1. Standard deduction tax relief (sec. 2 of the conference agreement)**

#### **Summary description of provision**

For taxable years beginning after December 31, 1999, the bill phases in an increase in the basic standard deduction for a married couple filing a joint return until it is twice the basic standard deduction for a single individual.

#### **Number of affected taxpayers**

It is estimated that the provision will affect approximately 25 million individual tax returns.

#### **Discussion**

It is not anticipated that individuals will need to keep additional records due to this provision. The higher basic standard deduction should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. In addition, the provision should not increase individuals’ tax preparation costs.

Some taxpayers who currently itemize deductions may respond to the provision by claiming the increased standard deduction in lieu of itemizing. According to estimates by the staff of the Joint Committee on Taxation, approximately three million individual tax returns will realize greater tax savings from the increased standard deduction than from itemizing their deductions. In addition to the tax savings, such taxpayers will no longer have to file Schedule A to Form 1040 or need to engage in the record keeping inherent in itemizing below-the-line deductions. Moreover, by claiming the standard deduction, such taxpayers may qualify to use simpler versions of the Form 1040 (i.e., Form 1040EZ or Form 1040A) that are not available to individuals who itemize their deductions. These forms simplify the return preparation process by eliminating from the Form 1040 those items that do not apply to a particular taxpayer.

This reduction in complexity and record keeping may also result in a decline in the number of individuals using a tax preparation service (or a decline in the cost of using such a service). Furthermore, if the provision results in a taxpayer qualifying to use one of the simpler versions of the Form 1040, the taxpayer may be eligible to file a paperless Federal tax return by telephone. The provision also should reduce the number of disputes between taxpayers and the IRS regarding substantiation of itemized deductions.

## **2. Expansion of the 15-percent rate bracket for married couples filing a joint return (sec. 3 of the conference agreement)**

### **Summary description of provision**

The provision increases the size of the 15-percent regular income tax rate bracket for married couples filing a joint return to twice the size of the corresponding rate brackets for a single individual. This increase is phased in over five years beginning for taxable years beginning after December 31, 1999. It is fully effective for taxable years beginning after December 31, 2003.

### **Number of affected taxpayers**

It is estimated that the provision will affect approximately 21 million individual tax returns.

### **Discussion**

It is not anticipated that individuals will need to keep additional records due to this provision. The increased size of the 15-percent regular income tax rate bracket for married couples filing joint returns should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision.

## **3. Interactive effect of the alternative minimum tax rules**

Both provisions (i.e., the standard deduction tax relief and the expanded 15-percent rate bracket) are affected by the alternative minimum tax (“AMT”) rules. Specifically, because neither provision makes corresponding changes to the alternative minimum tax regime other than the allowance of the nonrefundable personal credits against the AMT, additional individual taxpayers will need to make the necessary calculations to determine the applicability of the alternative minimum tax rules. It is estimated that for the year 2005, less than two million additional individual income tax returns with a benefit from the provisions will be required to include a calculation of the tentative minimum tax and file the appropriate alternative minimum tax forms. By the year 2009, this number is expected to rise to over seven million additional individual income tax returns. At the same time, however, by 2009, there will be approximately two million individual income tax returns that will be relieved of the burden of the AMT calculations by virtue of the extension of the nonrefundable personal credits against the AMT.

For taxpayers who have to calculate the tentative minimum tax and file the appropriate alternative minimum tax forms, it could be expected that the interaction of the provisions with the alternative minimum tax rules would result in an increase in tax preparation costs and in the number of individuals using a tax preparation service.

#### **4. Sunset (sec. 7 of the conference agreement)**

##### **Summary description of provision**

The provision sunsets the provisions and amendments made by the bill for taxable years beginning after December 31, 2004.

##### **Number of affected taxpayers**

It is estimated that the provision would affect almost all individuals affected by the other provisions of the bill.

##### **Discussion**

The provision would reverse any simplification achieved under the other provisions of the bill. Specifically, two categories of individuals would have additional record keeping and tax return filing complexity. First, individuals who, because of the bill changes, switch from itemizing deductions to using the increased standard deduction would likely revert to itemizing deductions when the increased standard deduction sunsets. Second, individuals who are relieved of the AMT calculations under the bill would be required to make such AMT calculations after the sunset. The sunset provision also can be expected to result in an increase in the tax preparation cost of individuals using a tax preparation service. In addition, the provision may require the IRS to issue guidance regarding the termination of the tax benefits as a result of the sunset.